

BOSTON  
CHICAGO  
FRANKFURT  
HAMBURG  
HONG KONG  
LONDON  
LOS ANGELES  
MOSCOW  
NEW JERSEY

EX PARTE OR LATE FILED  
**Latham & Watkins**

ATTORNEYS AT LAW  
www.lw.com

NORTHERN VIRGINIA  
ORANGE COUNTY  
PARIS  
SAN DIEGO  
SAN FRANCISCO  
SILICON VALLEY  
SINGAPORE  
TOKYO  
WASHINGTON, D.C.

ORIGINAL

ORIGINAL February 6, 2002

RECEIVED

FEB - 6 2002

William Caton  
Acting Secretary  
Federal Communications Commission  
445 12th Street, S.W.  
Washington, DC 20554

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Re: Ex parte presentation -- CC Docket No. 96-98 /- ACS of Alaska *et al.*  
("ACS") Petition to Amend Section 51.405 of the Commission's Rules,  
Petition for Reconsideration (FCC Public Notice, Rep. No. 2508, rel. Oct.  
19, 2001)

Dear Mr. Caton:

On Friday, January 25, 2002, Chuck Robinson and Wes Carson of ACS met with Jordan Goldstein of the office of Commissioner Copps to discuss the above-captioned proceeding. The substance of the discussion included the competitive and regulatory environment in Alaska broadly, as described in the attached materials (which were shared with Mr. Goldstein), as well as the points raised in ACS's Petition for Reconsideration, captioned above.

Please direct any questions concerning this matter to me.

Very truly yours,

Karen Brinkmann

No. of Copies rec'd 0/1  
List A B C D E

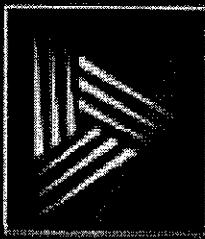
Enclosure

cc: Jordan Goldstein  
Senior Legal Advisor  
Office of Commissioner Copps

Alaska's Telecommunications Issues:  
Lessons Learned for Non-BOC and Rural Carriers

January 2002

ACCS



---

Alaska Communications Systems

# Overview

- The Telecom Act was a bold initiative aimed at changing the paradigm for achieving more efficient and innovative telecommunications, while ensuring access to affordable service
- Efficiencies and innovations are to be achieved through competition and market forces rather than regulation
- Small companies serving rural areas should be exempt from some forms of competition to ensure access to affordable services in high cost areas

# Unfinished Business

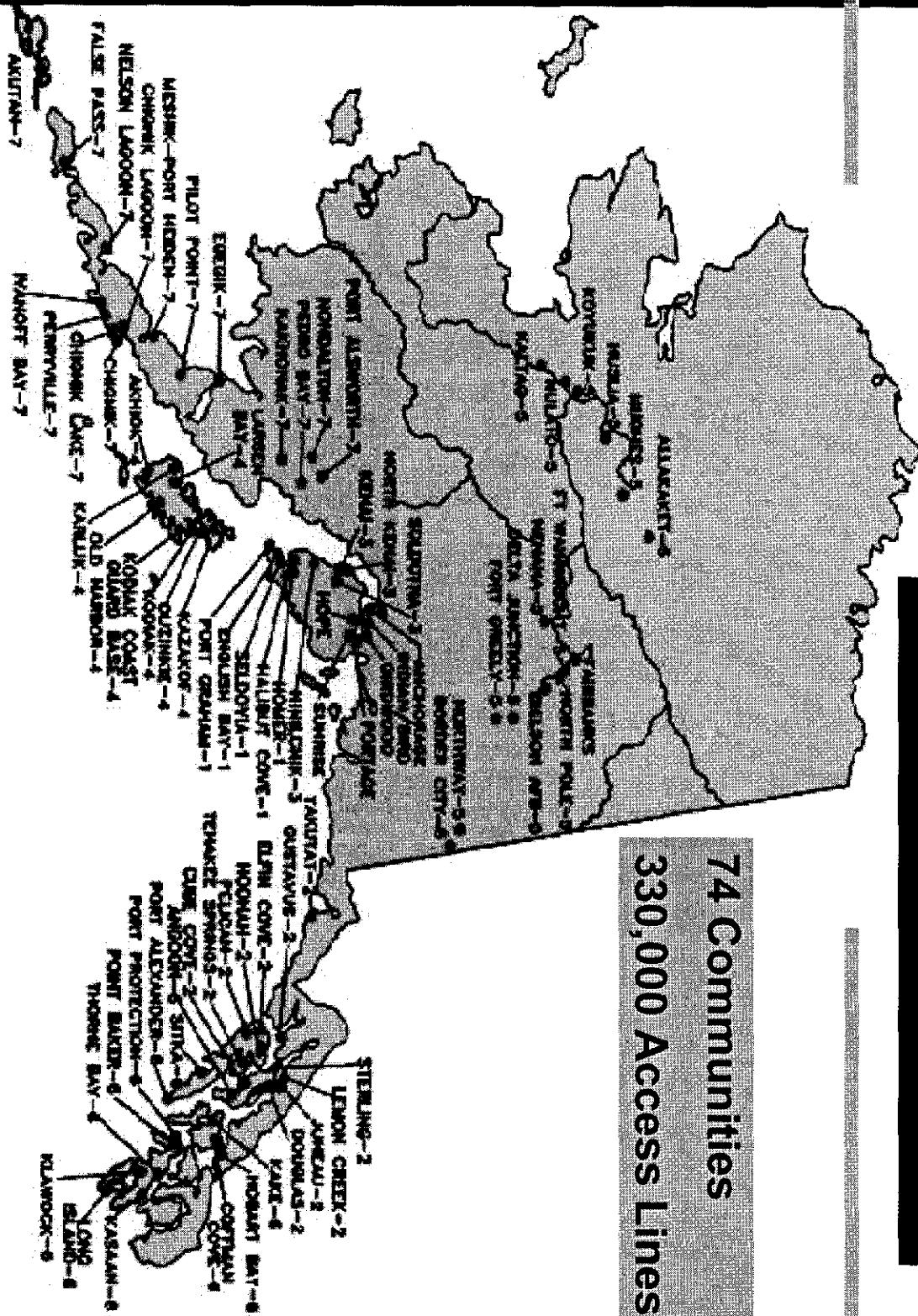
- Competition. Must be fair.
- Rural Markets. Protections for consumers must be enforced
- Broadband Deployment. Must have adequate incentive to invest.

# Alaska Is Different

- 365,000,000 acres (1/5 of Lower 48 States)
- 625,000 total population (Bakersfield, CA: 662,000)
- 1.09 persons per sq. mile (South Dakota: 9.9; CA: 217.2)
- 11 highways; 14,500 miles of road (about 25% paved)
- More than 140 communities not connected by any road
- Extreme climatic conditions (+100° to -80°F)

ACS Serves Alaska

**74 Communities  
330,000 Access Lines**



# ACS ILECs

- Anchorage; no USF
- Local competition since 1997
- 41% market share loss to CLECs

## *ACS of Anchorage*

- Fairbanks and environs
- RTC; \$5 Million annual USF (\$125/line/year)
- Competition ordered in 1999

## *ACS of Alaska*

- Juneau-Douglas (State capital)
- RTC; \$2 Million annual USF (\$42/line/year)
- Competition ordered in 1999

## *ACS of the Northland*

- 70 rural communities
- RTC; \$20 Million annual USF (\$330/line/year)
- Competition ordered in 2002



# ACS of Anchorage

## Not a BOC - 2% and Rural Carriers Require Different Treatment

- ACS of Anchorage was never part of the Bell System
  - Not BOC "successor or assign"
  - Not subject to §271/272; no intra-LATA toll service 'carrot'
- ACS-Anchorage serves one isolated, small market
  - Erie, PA; South Bend, IN; and Killeen, TX are larger markets
- ACS of Anchorage lacks the big customers, line density, multi-state operations, economies of scale, and big revenues of the BOCs
- ACS has lost 41% market share to CLEC competitors
  - Average BOC loss is a mere 8.5% overall, 4.6% residential  
(FCC Local Telephone Competition Report - May 21, 2001)

# ACS of Anchorage BOC Policies Disserve Public Interest

- ACS does not require inducements to open a market which is already fully open to competition
  - 59% residual market share
  - Temporary, interim non forward-looking and excessively low UNE rates for five years
- Principal CLEC owns non-common carrier CATV facility with no open access obligations or rate regulation
- Asymmetrical regulatory burden hampers further competition
  - Promotes uneconomic CLEC arbitrage schemes
  - Disincentivizes ILEC and CLEC infrastructure investment

# ACS of Anchorage

## Impairment of Infrastructure Investment

- All major telecommunications companies serving Anchorage market have lost money (CY2000)
  - ACS lost approximately \$25 million
  - GCI lost approximately \$21 million (Before NOLs)
  - AT&T lost approximately \$30 million (Best Estimate)
  - WCI/AFS lost in excess of \$50 million
- ACS of Anchorage, the carrier-of-last-resort, had an \$18 Million (36%) revenue deficiency in Anchorage
  - GCI has not been willing to construct new telecommunications facilities
  - AT&T has abandoned alternative broadband wireless network
  - WCI/AFS is in bankruptcy

# ACS of Anchorage Not Dominant Any More, In Any Way

*"My colleagues on other state commissions are astonished to hear that a competitor has captured 35-40% of the Anchorage market."*

G. Nanette Thompson, Chair, Regulatory Commission of Alaska, Speech to Anchorage Chamber of Commerce, July 30, 2001 at 2.

# ACS of Anchorage

## Going to the Next Level of Competition

- Reduce FCC regulatory involvement in competitive marketplace
  - Stop imposition of new regulatory requirements derived from BOC size, resources, market presence and 1996 Act provisions
  - Examples: OSS, access charge reform, alternative regulation
- Reduce asymmetrical burdens through rule reform and forbearance
  - Actively promote § 10, § 11 forbearance of existing rules
  - Apply sunset limitation of three (3) years on residual rules
  - Examples: Separate affiliate rules, accounting requirements
- Apply non-dominant carrier treatment to ACS of Anchorage
  - Pricing flexibility, filing support requirements, detariffing
- Ensure FCC policies are fully, consistently carried out
  - Require conforming state commission conduct

# Competition Requires Market Rationalization

- Having required competitive markets, the FCC has an obligation to ensure the playing field is level
- The FCC should require States to remove unfair burdens on Two Percent and Rural ILECs exposed to competition
- Market rationalization needs to occur prior to exposure to competition

# Rate Structure

## Monopoly Era Social Policy Created Implicit Subsidy In Rates

	<u>Anch.</u>	<u>Fairbanks</u>	<u>Juneau</u>	<u>Northland</u>
Residential	\$9.70	\$12.50	\$9.42	\$16.30
Business – Simple	25.75	25.50	17.65	26.05
Business – Complex	33.00	29.50	28.95	34.60
Composite	\$15.50	\$21.20	\$13.35	\$20.70



# Regulatory Arbitrage

Implicit Subsidies & Monopoly Era Rate Structure Creates  
Arbitrage Opportunity for CLECs

- Composite Total Revenue \$40.00
- Business Rate \$33.00
- Composite Rate \$15.50
- Residential Rate \$ 9.70 12.05

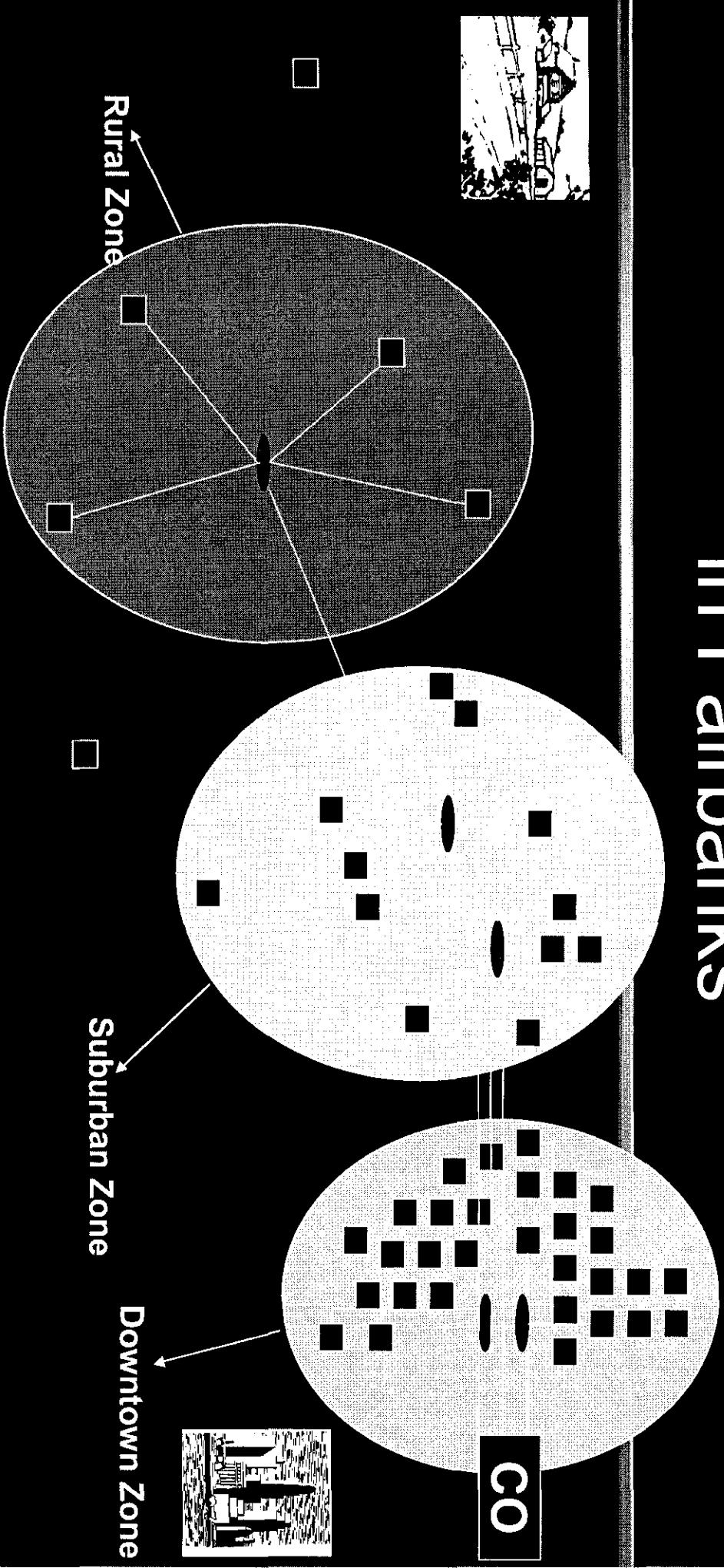
# ACS of Fairbanks, Inc.

- \$5 million in Annual USF Subsidies (\$10/line/month)
- “Postage Stamp” Rates (Costs vary by > 2,000%)
- Business Subsidy (over 230% of Residential)\*
- Disaggregation Review Pending since 1996
  - will self-certify this month - but the two zones allowed are insufficient
- Rural Exemption for Fairbanks under judicial review

\*See Appendix A



# Need for Deaveraging and Disaggregation in Fairbanks



**Disparate Costs:** Range from \$7/mo. To \$177/mo.  
**Averaged Rates - Averaged UNE - Averaged USF**

## Fairbanks Costs

Non-compensatory UNE Rate Destroys  
ILEC Incentive to Invest in Plant

- Embedded Cost per Loop  
(used by USAC to compute  
Universal Service support)
- Forward-Looking Cost per  
Loop (approved by the RCA)
  - \$ 33.24
  - \$ 19.19
- *Forward-Looking Economic  
Cost According to ACS*
  - \$ 36.01

# Fairbanks Arbitrage Opportunity

## USF Support Exacerbates Regulatory Arbitrage In Rural Markets

<u>REVENUE SOURCE</u>	<u>RETAIL</u>	<u>UNE</u>
Basic Local Service	\$21.00	0
Custom Calling Features	\$ 6.00	0
UNE Revenue	0	\$19.19
Interstate Access	\$12.00	0
Intrastate Access	\$ 9.00	0
<b>TOTAL</b>	<b>\$ 48.00</b>	<b>\$19.19</b>
USF Impact	\$ 9.00	-\$ 9.00
NET TO ACS	\$57.00	\$10.19

# Going to the Next Level of Competition

*State commissions are unavoidably pro-regulatory:*

"There is a very strong tendency for government agencies imbued with the traditional public utility regulatory philosophy to carry over into putatively competitive areas the same tendency to assume direct responsibility for the outcome, by micromanaging and handicapping the competitive process itself, in ways that threaten to jeopardize the very benefits that competition would otherwise bring to consumers."

Alfred E. Kahn, *Deregulation: Micromanaging the Entry and Survival of Competitors*, The Edison Electric Institute, Washington, D.C. (February, 1998) at 7.

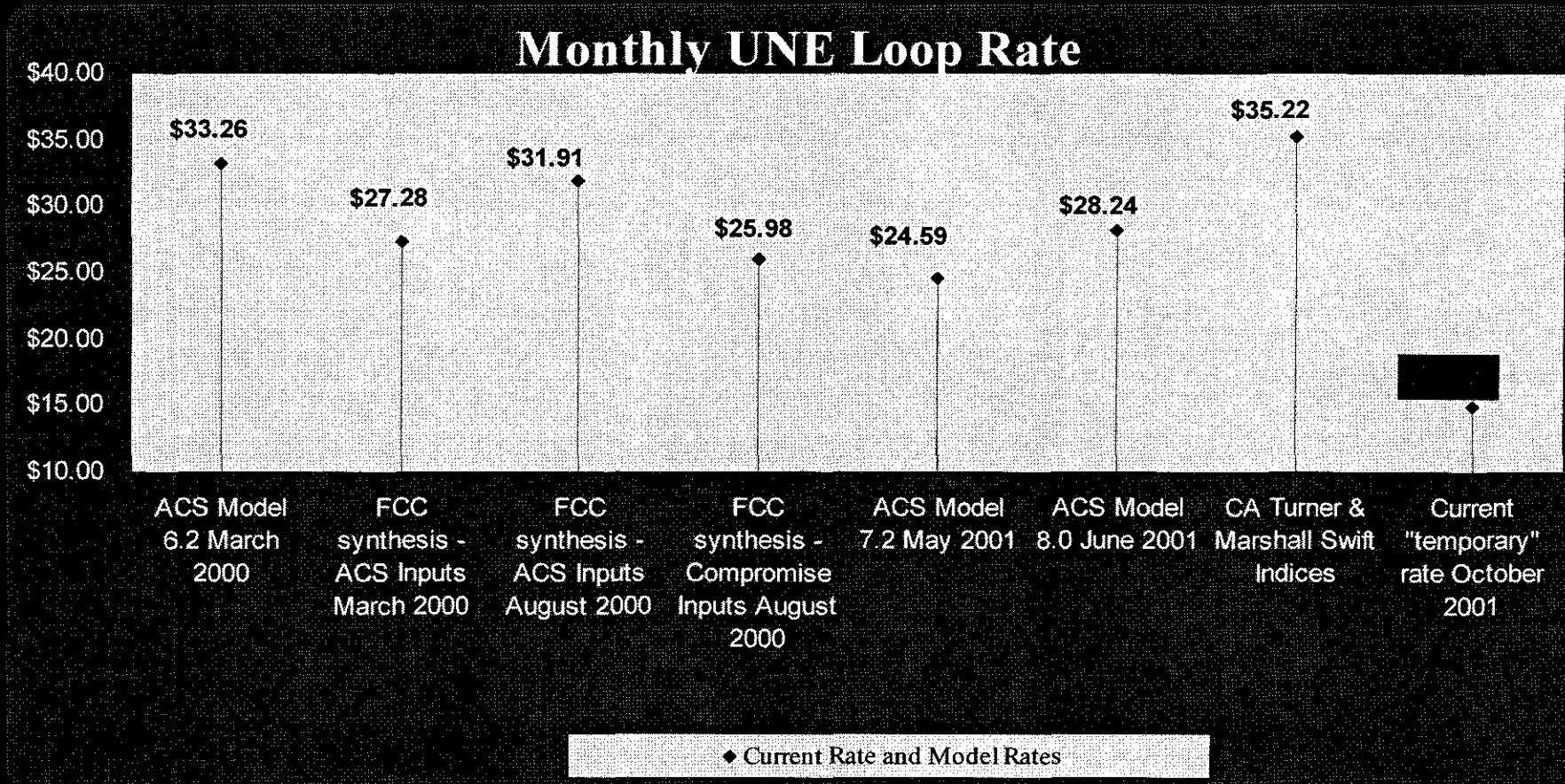
## These Issues Have Not Been Addressed In Alaska

- Averaged “*postage stamp*” rates result in low-cost customers subsidizing high-cost customers (“implicit subsidy”)
- Artificially high *business rates* supporting artificially low *residential rates* (“implicit subsidy”)
- Artificially low UNE rates subsidize competitors
- **USF support** for high cost areas (“explicit subsidy”) is being improperly used to subsidize CLECs

# Market Rationalization

- Rates should be de-tariffed where sufficient competition exists
- Where tariffs continue, ILECs should be allowed to match rates with costs by:
  - rebalancing business and residential rates
  - deaverage prices and allow for retail and UNE prices to vary according to cost of service
  - synchronize reforms to avoid opportunities for regulatory arbitrage

# ACS UNE Rates for Anchorage: Anchorage UNE Is Not Compensatory



Note: The key to fair rates is using ACS' actual cost. See Appendix B.



# FCC Reform of USF Is Needed

- Avoid competition for subsidies, not customers
  - CLECs designated Eligible Telecommunications Carriers (“ETCs”) receive USF \$ based on ILEC costs, not their own
  - CLECs arbitrage UNE/aggregated USF, pocket the difference
- Avoid impairment of infrastructure investment
  - CLECs serving through UNEs do not maintain local loop, do not make investments in new telecom facilities, do not have to account to FCC for use of proceeds
  - ILECs receive UNE prices, not USF \$, lose ability and incentive to invest in current or advanced facilities
- Avoid waste of limited universal service resources
  - Public dissatisfaction with ‘bill creep’



# USF In Fairbanks

- GCI granted ETC status (8/28/01) making them eligible to receive the same per line support as ACS
- No ILEC is eligible to receive USF funds unless their loop rate exceeds \$23.00
- ACS's loop costs are \$33.24
- GCI's UNE loop costs are \$19.19 - GCI makes no real investment in local loops
- GCI should not receive high cost loop support in this situation



# Recommended FCC Reform of USF

- The FCC should base USF flowing to CLECs on the CLECs costs - capped at the rate paid to the ILEC
- Correct prior FCC interpretation of §214(e)(1)(A) “own facilities” requirement to mean carrier’s own facilities
- Allow self-certified disaggregation for up to six zones for USF funding purposes
- Increase USF, as necessary, to offset reductions in access charge revenues



# Rural Exemption Inconsistencies Between The States

- Section 251 of the Telecom Act exempted rural telephone companies from the duty to negotiate re-interconnection, unbundled access, resale and collocation *UNLESS...*
- Bona fide request . . . “is not unduly economically burdensome . . . and is consistent with section 254” (which includes “specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service”).



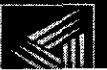
# *“Iowa Utilities Board I and II” Decisions*

- U.S. Supreme Court upheld the FCC’s authority to issue national rules prescribing how state commissions should apply the Telecom Act - including rules related to terminating the rural exemption.
- On remand, the 8<sup>th</sup> Circuit vacated FCC’s rule governing burden of proof in proceedings before state commissions to terminate a rural exemption
  - Decision interpreted the Telecom Act to require that –
    - the burden of proof must be on CLEC, not the rural ILEC, and
    - The economic burden associated with competitive entry must be considered
  - No disagreement with FCC re need for national rule to promote consistent treatment of carriers
- The CLEC: GCI filed for Supreme Court review, which was denied



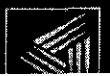
## *Alaska's Reaction to "Iowa II"*

- **The Regulatory Commission of Alaska:** “The 8<sup>th</sup> Circuit’s ruling on the assignment of the burden of proof in a rural exemption proceeding does not persuade us to revisit that issue here. . . . To assign the burden of proof to the CLEC would be impractical.”
- **The Alaska Superior Court:** “The 8<sup>th</sup> Circuit’s decision . . . does not require a stay nor is it persuasive of the merits of a stay.”



# The ACS Petition for Reconsideration

- The Common Carrier Bureau denied ACS' request that the FCC adopt a rule consistent with the ruling of 8th Circuit, claiming it is unnecessary as the FCC is bound by the 8th Circuit's decision.
- The Common Carrier Bureau fails to address the issue of rogue states, such as Alaska, not being bound by the 8th Circuit decision
- ACS has petitioned the FCC to reconsider the CCB's decision. The FCC should adopt a rule requiring CLECs to bear the burden of proof when terminating a rural exemption



# Glacier State Study Area

- Rural isolated communities totaling about 60,000 people
- The largest communities are:

Delta Junction	840
Ft. Greely	461
Homer	3,946
Kenai	6,942
Kodiak	6,334
Nenana	486
Ninilchik	772
North Pole	1,570
Seldovia	286
Soldotna	3,759
- Local loop costs average \$50.00/line/month
- USF averages about \$27.50/line/month



# State Commission Position Glacier State Study Area

“We have a responsibility to carry out the intent of Congress in adopting the Telecommunications Act of 1996, which is to require competition in the provision of local telecommunications services.”

RCA Docket No. U-97-144, Order No. 12, January 18, 2002,  
*Order Denying (ACS') Motion for Clarification* setting forth the the commission's intent that the rural exemption be terminated for all of the Glacier State study area for all purposes



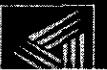
# Conclusion

- The Alaskan experience highlights the need for appropriate balancing of the Telecom Act's provisions relating to competition, deregulation, universal service and broadband deployment.
- Where competition exists, the market - *not the regulators* - should determine prices for retail rates and UNEs
  - ACS is currently required to spend millions of dollars adjudicating a traditional rate case in fully competitive markets
- To ensure fair competition, rational market structures must establish:
  - Rebalanced business and residential rates
  - Retail rates and UNE prices that reflect costs - *not social policy*
  - Disaggregation based on the carrier's cost of maintaining universal service



## Conclusion (cont.)

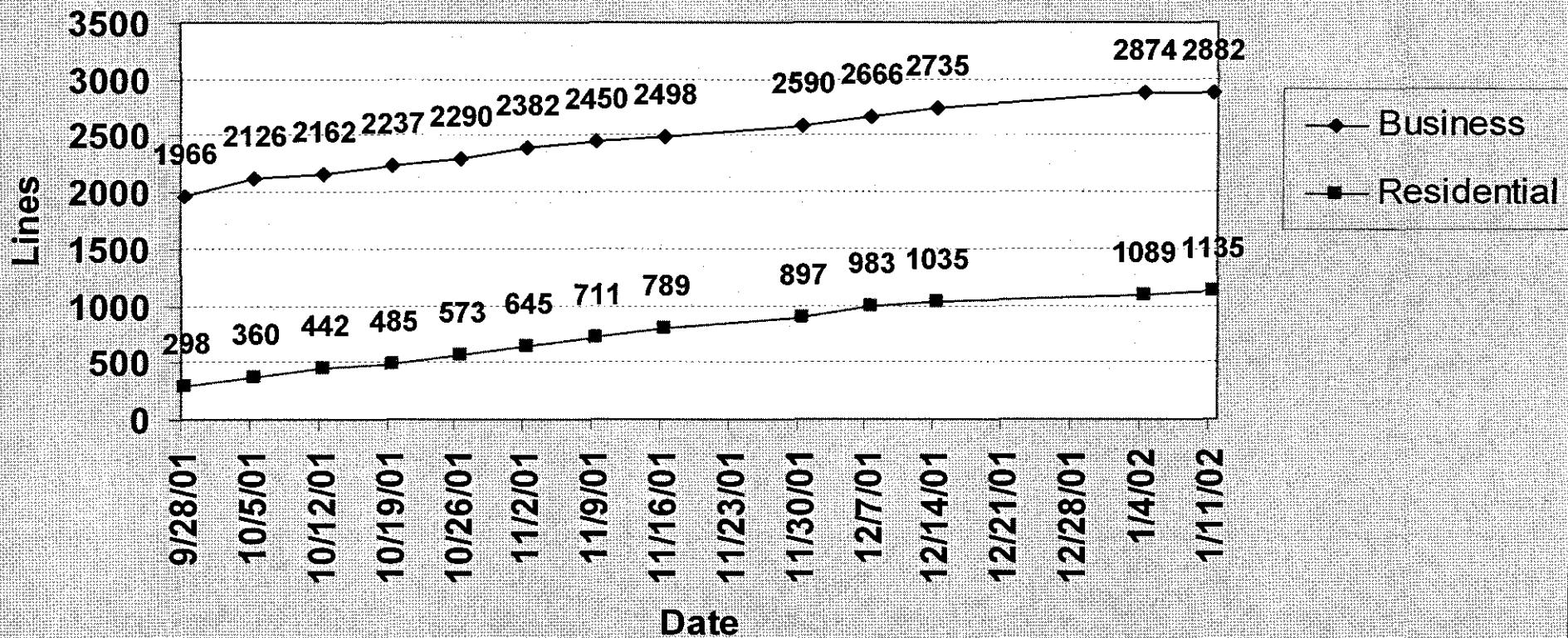
- Fair development of competition requires rational market structure
- Fully competitive markets must be deregulated
- Rural markets must be exempted from competition unless there is a clear showing that the market can support multiple providers



# Appendix A

## CLEC Strategy in Fairbanks

### Wholesale Sales To GCI in Fairbanks



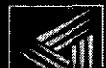
# Appendix B

## ACS UNE Rates

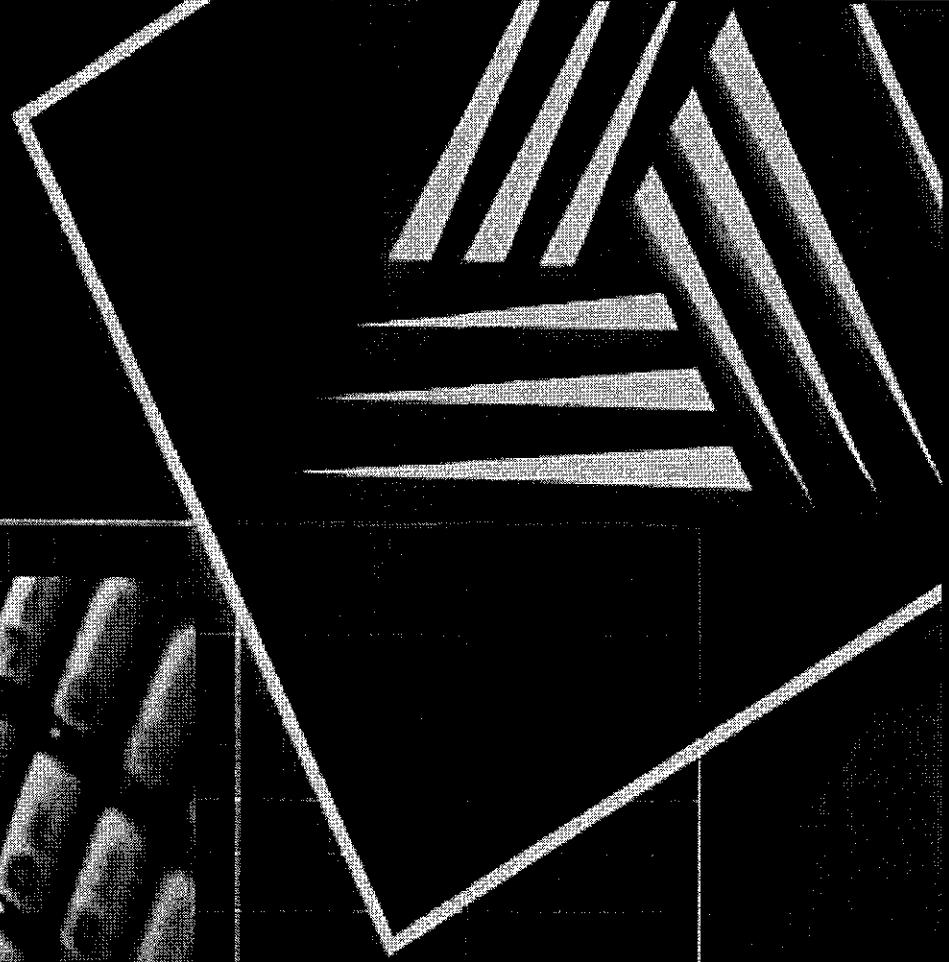
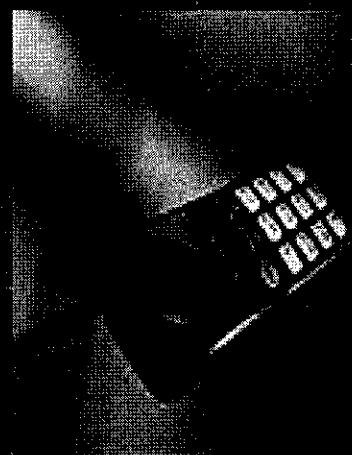
- UNE Rates should be based on ACS' costs
- The RCA, however, requires the use of national average default inputs

- The RCA relies on the FCC's HCPM Model designed for Universal Service Fund Support
- Result: ACS is being forced to lease UNEs at rates below its own costs

	<u>ACS FLEC</u>	<u>HCPM Default</u>	<u>% of FLEC Cost Recovered</u>
Man-hole			
2 duct capacity	\$ 5,318	\$ 1,436	27%
9-duct capacity	\$ 11,952	\$ 5,176	43%
Duct cost per kilo-foot	\$ 6,787	\$ 720	11%
NID cost	\$ 89	\$ 27	30%
Drop cost per kilo-foot	\$ 2,840	\$ 560	20%
Digital Loop Carrier			
Fixed cost per 2016 f.o. terminal	\$236,143	\$152,617	65%
Fixed cost per 24 f.o. terminal	\$ 28,581	\$ 19,881	70%
24 Gauge Copper Buried Cable \$/ft			
200 pair	\$ 5.85	\$ 2.63	45%
900 pair	\$ 15.43	\$ 9.51	62%
1800 pair	\$ 27.19	\$ 18.37	68%
2400 pair	\$ 35.24	\$ 24.27	69%



ACS



**LEGG MASON TELECOMMUNICATIONS CONFERENCE  
WALDORF – ASTORIA HOTEL  
THURSDAY, FEBRUARY 7, 2002**

*ORIGINAL*

**ITINERARY**

**WEDNESDAY – FEBRUARY 6, 2002**

**4:00 P.M. -- DEPART WASHINGTON, DC – UNION STATION**

**RESERVATION NO: 0529F6**

**TRAIN NO: 2172 – ACELA EXPRESS**

**ARRIVE NY PENN STATION: 6:44 P.M.**

**6:50 P.M. – CHECK-IN WALDORF – ASTORIA HOTEL**

**CONFIRMATION NO: 3142914786 (QUEEN BED DELUXE -- \$249.00 PER NIGHT)**

**7:00 P.M. – COCKTAILS**

**LOCATION: WALDORF – ASTORIA HOTEL**

**THE HILTON ROOM**

**8:00 P.M. – DINNER**

**LOCATION: WALDORF – ASTORIA HOTEL**

**THE HILTON ROOM**

**THURSDAY – FEBRUARY 7, 2002**

**7:00 A.M. UNTIL 4:00 P.M. – ATTEND TRACK #1 – RURAL CONSOLIDATION**

**LOCATION: EMPIRE ROOM (AGENDA ATTACHED)**

**4:30 P.M. – DEPART NEW YORK PENN STATION FOR WASHINGTON, D.C.**

**RESERVATION NO: 0529F6**

**TRAIN NO: 129 METROLINER**

**ARRIVING: 7:25 P.M.**